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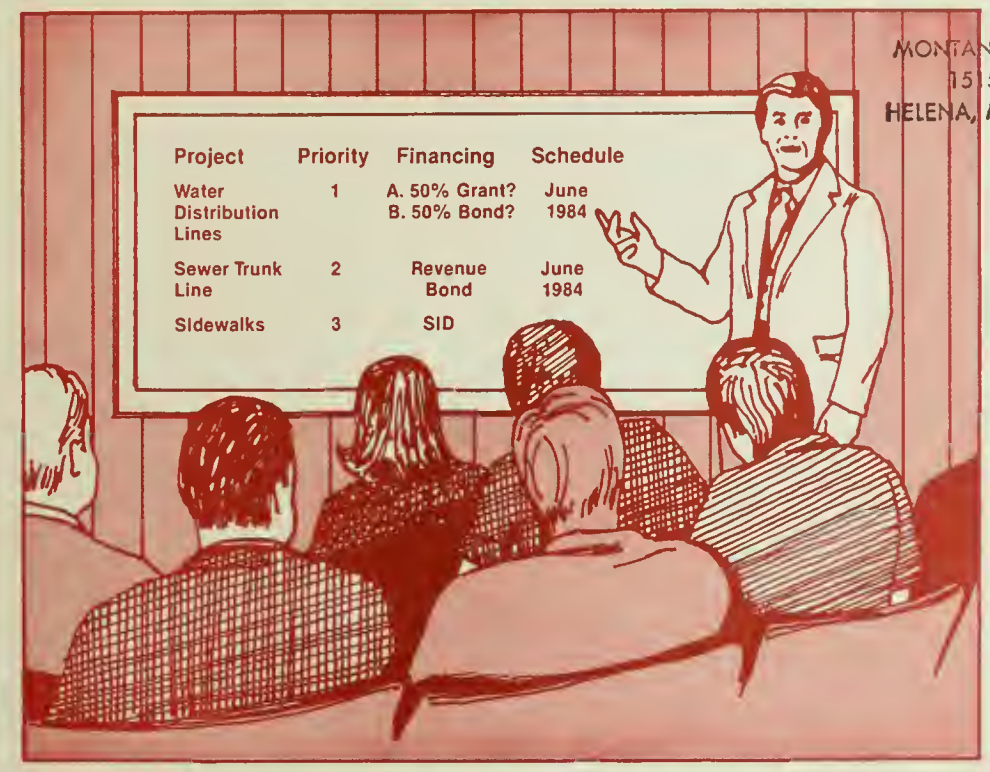
A HANDBOOK: CAPITAL FACILITIES SCHEDULING AND FINANCING



June 1983

Build Montana

MONTANA DEPARTMENT OF COMMERCE
Community Development Division

A HANDBOOK: CAPITAL FACILITIES

SCHEDULING AND FINANCING

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PREFACE

Abstract

The information contained in this document was prepared by Jim E. Richard, Consultant, pursuant to a contract with the Montana Department of Commerce. Funding for the project was provided by the Montana Community Development Block Grant Program.

This publication is designed to provide an over view of the capital facilities scheduling and financing process for Montana communities. This publication is of interest to local government elected officials and local government technical staff who are faced with decisions regarding cost efficient planning, scheduling and financing of capital facilities - sewer facilities, water facilities, jails, streets and roads, administrative buildings, and other public facilities.

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CHAPTER 1. INTRODUCTION

Capital facilities decisions represent significant policy choices for local governments. High costs frequently are involved when a new road, water system or jail facility is built.

Virtually all units of local government in Montana face the need for capital facilities--new or expanded projects,repair or replacement of existing physical facilities, land acquisition, or construction of new facilities such as community centers, parks and playgrounds, fire stations and water or sewer systems. Some communities are experiencing significant growth because of resource development. Others face the need to replace or repair deteriorating facilities in an environment of stable or declining population and tax base. Roads and streets, water, sewer fire,and jail facilities need replacing or improving. As an example, a 1983 survey showed that Montana cities and towns need to spend approximately $100 million just to provide adequate water systems.

These facility needs are arising at a time when local governments face decreasing taxable valuation and greatly reduced federal financial assistance. To add to the fiscal problems inflation keeps local dollars from buying as much as they once did. In addition, Montana taxpayers are expressing a resistance to increased property taxes--the primary source of local revenues.

Bond underwriters are demanding more evidence of fiscal solvency and efficient management from communities. Proposals for public investment are carefully examined and weighed against competing offers. More and more federal and state grant programs are requiring local applicants to demonstrate a capacity to properly manage capital facilities.

Capital facilities are "big ticket" expenditures. Local officials facing the need for capital expenditures must avoid costly mistakes. Citizens are demanding, more than ever, the wisest use of community dollars.

Most local government operating budgets are tied directly to past decisions on development and the provision of public facilities. Much of a local government's operating budget, for example, is concerned with maintenance of physical facilities--streets and roads, parks, water and sewer systems, which were built at some point in the past. Even the costs of services such as law enforcement or fire protection are the results of development decisions made in previous years.

In other words, the level of today's annual operating costs is largely dependent on prior capital investment decisions. Those decisions to build capital facilities more than likely followed, and were made in response to, development decisions (e.g., approval of subdivisions, shopping centers or industrial parks). Unfortunately, those development decisions very likely were made with little or no consideration for the future cost implications.

While capital improvements are originally built to respond

to present and anticipated future needs, they can foster change as well. Water and sewer lines, for example, not only meet existing needs, but also can encourage further development. Upgrading a road not only may relieve overcrowded travel conditions, it may promote additional growth.

Through thoughtful, systematic planning and scheduling, local officials can help assure that the taxpayers will get their money's worth from capital facilities expenditures. Developing a CAPITAL FACILITIES PROGRAM is a process of planning and scheduling the financing and construction of future public works. The process involves an assessment of all the facilities that the jurisdiction likely will need in the foreseeable future. A capital facilities program allows local officials to examine all the needs for new, expanded or repaired facilities, and set a realistic schedule for construction and funding.

Even small governmental units face financial pressures and difficulties just as do larger jurisdictions. They may not have as many capital needs, but they too can realize all the benefits from facilities planning and scheduling. The sophisticated approaches appropriate for large communities are not necessary for a great number of Montana local governments. A CAPITAL FACILITIES PROGRAM NEED NOT BE COMPLEX; IT SHOULD SUIT THE PARTICULAR COMMUNITY.

CHAPTER 2. BENEFITS OF PROGRAMMING CAPITAL FACILITIES

A systematic, organized approach to planning capital facilities provides a number of real and practical advantages:

Using taxpayers dollars wisely. Advance planning and scheduling of community facilities may avoid costly mistakes. The effort put into deliberate assessment of the need for repair, replacement or expansion of existing public works, as well as careful evaluation of the need and timing of new facilities can provide many savings. Project timing may be improved to better use available personnel, expensive equipment and construction labor by scheduling related major activities over a longer period. Coordination of construction of several projects may effect savings in construction costs (a newly paved street may not have to be torn up to replace utility lines). Overbuilding, or underbuilding usually can be avoided. Needed land can be purchased at lower cost well in advance of construction.

Focusing on community needs and capabilities. Public works projects should reflect the community's needs, objectives, expected growth and financial capability. Assuming each community has limitations for funding capital facilities, planning ahead will help assure that high priority projects will be built first.

Obtaining community support. Citizens tend to be more receptive toward projects which are part of a community-wide analysis. A high priority project which is part of an overall plan is less suspect as being someone's "pet project." Where the public participates in the planning of community facilities the citizens are better informed about the community needs and the priorities. A capital facilities program reduces the pressure on elected officials to fund projects which may be of low priority. One of the primary benefits of a community facilities program is that BECAUSE THE CITIZENS PARTICIPATED, THEY ARE MORE WILLING TO SUPPORT BOND ISSUES, RATE INCREASES AND OTHER FUNDING METHODS.

Encouraging economic development. Typically, a firm considering expansion or relocation is attracted to a community which has well planned and well managed facilities in place. Also, a capital facilities program allows private investors to understand a community's tax loads and service costs, and reflects the fact that the community has done some advance planning to minimize the costs of capital facilities.

More Efficient Administration. Coordination of capital facilities construction,both within a jurisdiction and among city, county and special districts,can reduce scheduling problems, conflicts and overlapping of projects. Also, work can be scheduled more effectively when it is known in advance what, where and when projects are to be undertaken.

A capital facilities program allows a community to anticipate lead times necessary to conduct bond elections and bond sales, prepare design work and let contract bids.

Maintaining a stable financial program. Abrupt changes in the tax structure and bonded indebtedness may be avoided when construction projects are spaced over a number of years. Major expenditures can be anticipated, resulting in the maintenance of a sound financial standing through a more balanced program of bonded indebtedness. Where there is ample time for planning, the most economical methods of financing each project can be selected in advance. Keeping planned projects within the financial capacity of the community helps to preserve its credit and bond rating and makes the area more attractive to business and industry.

Federal and state grant and loan programs. A capital facilities program places the community in a better position to take advantage of federal and state grant programs, because plans can be made far enough in advance to utilize matching funds, both anticipated and unanticipated. Most federal and state grant/loan programs either require prior facilities planning, or favor, in ranking applications, applicants which have conducted such planning.

CHAPTER 3. DEFINITIONS

A capital facility is a major, high cost, non-recurring project, having a life of two or more years, which cannot be funded out of one year's operating budget. Thus, a local jurisdiction usually incurs debt in order to finance a a capital facility. A capital facility typically is a fixed asset. Examples include buildings, utilities, land, airports, and heavy road maintenance equipment.

Many people refer to capital facilities as "capital improvements." In this publication the terms "facility," "improvement" and "project" mean the same and are used interchangeably.

In contrast, items purchased as operating expenses are recurring, low cost items which are included each year in the operating budget. The costs for personnel, office equipment, maintenance and operation are operating costs and should not be financed by incurring debt, but rather through annual budgets.

Certain items may fit either category, depending on how the local officials choose to define them. Vehicles, computers, expensive communications equipment are examples. Local officials should set a policy regarding what items are capital expenses and what are operating expenses.

A capital facilities program is a plan and schedule for providing capital expenditures over a period of time, typically five or six years. The program specifies the needed facilities, approximate costs, expected revenue sources and schedule for construction.

A capital facilities program can take any form that suits a community. In its simplest form a capital facilities program is a list of needed capital projects, their estimated costs, a schedule of their construction and a means of financing each project. A simple facilities program will serve small units of local government well. Larger communities likely will find that a suitable capital facilities program is more complex and requires a more involved process to develop an appropriate program.

As explained below, a capital facilities program is not a means of appropriating money for a project. Funds for a project are appropriated by the capital budget. A capital budget is a more detailed list of specific capital expenditures and revenues, which is adopted as part of the current year's annual budget.

A capital facilities program is a plan and does not represent a commitment on the part of local government. However, a capital budget,which includes the current year's capital expenditures and revenues, is adopted as part of the current annual budget and becomes a commitment on the local government when local officials adopt an annual budget as required by Montana law.

CHAPTER 4. THE PROCESS

The major phases in developing a capital facilities program are outlined below. Local officials must decide how elaborate their approach should be and who will conduct the various steps for their community. Section F. WHO DOES WHAT? offers ideas.

The steps include:

(1) Identifying the needs for facilities, the timing, costs and means of financing for each project;

(2) Preparing a financial analysis of the jurisdiction's capacity to pay for new facilities;

(3) Setting priorities among the proposals;

(4) Seeking review and comment by the public on the recommended projects and priorities;

(5) Preparing a final capital facilities program is prepared showing projects, priorities, schedule of completion and methods of funding each project;

(6) Adopting the capital facilities program by the governing body and adopting first year's projects as a capital budget as part annual budget; and

(7) Reviewing the capital facilities program annually.

NOTE: A comprehensive plan is not necessary to carry out this process, but communities which have adopted a community plan will find the process much simpler.

At least the following local personnel should be involved:

Elected Officials.

Elected officials are the most important persons in the process of developing a capital facilities program. First, they are the only people with the powers to adopt and carry out a capital facilities program. They also are the ones who should initiate the process within their jurisdiction.

Governing officials must be committed to using the capital facilities program in making future decisions about facilities. If that commitment is not present, the facilities program will not be used, and the time and effort spent on its development will have been of little value.

The governing officials should initiate the development of a capital facilities program. They should request all heads of the local operating departments (e.g. road, sheriff, public works, fire), special districts and boards within the jurisdiction (e.g.park, airport, solid waste)to prepare background information regarding existing facilities and project proposals The governing body will want to assure that the departments and districts follow through in preparing project proposals and suggested priorities by the deadline set by the elected officials.

The elected officials must set final priorities, decide on the best funding methods and set a schedule for initiating and constructing each project. The governing body adopts the capital facilities program and approves the first year's projects in the current annual budget.

Heads of departments and special districts.

The head of the operating departments, boards and special districts should be responsible for examining all the existing facilities within their agencies, determining what major repairs or replacements will be needed and when, and what new or expanded facilities will be needed to meet expected demand. Each agency should also provide supporting information for any proposed projects and suggest priorities among its own proposals.

Planning Board, Planner, or Coordinator.

A person or agency should be assigned the responsibility for coordinating the preparation of the capital facilities program. The planning board and planning staff often are in the best position to coordinate the facilities program because they usually have been involved in overall planning for the community.

Where there is no planner or planning board, or the planning department simply cannot handle the additional work load, some person or committee should be appointed. A special committee might comprise the clerk or budget officer and representatives of the various departments and districts.

Good program coordination requires working with department heads and other officials in the jurisdiction who will be involved in the process and, where appropriate, with other governmental units in the area.

The coordinator must have certain information available: a complete inventory of existing facilities, their condition, capacity and need for repair or replacement; existing policies; data regarding the financial capacity of the community to pay for new facilities; and priorities of the jurisdiction.

Budget and Tax Officials.

Municipal clerks, county clerk and recorders, county appraisers and other local officials involved with finance and budgeting will need to supply information on budgets, taxable valuation, mill levies and bonded indebtedness.

In larger cities and counties the finance and budget officer(s) should be involved to provide financial analysis and projections, review the implications project requests have on both the operating and capital budgets, and the best means of financing each project.

SUGGESTION: Capital facilities planning is best conducted when local officials are not immersed in annual budgeting. However, any time of the year is better than no time at all.

CHAPTER 5. PROJECTING CAPITAL NEEDS

1. THREE CATEGORIES OF NEED.

The need for capital facilities results from three circumstances:

A. the population of a jurisdiction increases;
B. existing facilities need major repairs or replacement; and
C. a change occurs in goals of the community, or in the structure of the population.

In the first circumstance, the need to build new or expanded facilities to serve a growing population is obvious, as it is in the second--where repair or replacement of existing facilities is necessary.

The need for new facilities in the third instance can take several forms. A community may decide to encourage economic development, for example. In order to accomodate existing business and industry's desire to expand, or to encourage new firms to locate in the community, new or improved facilities may be desirable, or facilities of a different type or purpose may be necessary. Streets or roads may need upgrading to facilitate truck transportation. An industrial firm requiring large quantities of water probably will not consider locating in community with an inadequate water system.

The citizens of a community may desire higher levels of services, such as better police or fire protection, or better streets. They may decide that they want more park and recreation facilities.

The population of a community may not be increasing overall, but may be changing in composition. A community attracting retired persons may experience a greater need for senior citizens services and facilities.

a. Population Projections. Because local public services, including capital facilities, serve people, the required size,or capacity, of a facility is almost always dependent on the size of the population. Usually a direct relationship exists between the total population of a jurisdiction and the needed capacity of a facility to properly serve that population. In many cases a more reliable measure of the needed capacity of a proposed facility is a specific segment of the population, such as number of school-age children for schools, number of elderly for hospitals and nursing homes or number of households for water and sewer systems.

Thus, projecting the need for future facilities is dependent on sound estimates of total population and on estimates of individual segments within the total population.

For schools, the number of students in elementary, junior high and high school grades should be projected. The number of classrooms and special purpose rooms is dependent on the number of students. Other facility needs, such as laboratories, physical education and shops, will depend not only on the number of students but also on decisions by the school board with regard to

the level of education and the curriculum desired.

The number of senior citizens (60 years and over) should be estimated to determine the need for senior citizen facilities (senior centers, nursing homes, hospital and clinics,). Often some senior citizen needs are met by private or volunteer organizations. A thorough capital facilities plan explores this approach and, where available, incorporates it into the facilities plan.

A community facing rapid growth because of major development such as energy or mineral activities should examine several special aspects of facility needs. First, the firms or agencies responsible for the growth should be contacted to determine the magnitude and timing of the development. Population levels should be projected for approximately 10 years to indicate if the population will peak (e.g. during construction of a major plant) and then decline to a long term operating level. If the population peak will exist for only a few years, the local officials probably will want to design new facilities for a capacity which will adequately serve less than the peak level.

During the time when the population is at peak levels which exceed the design capacity of a facility, the community may be able to manage with an underdesigned facility by reducing the level of service provided (e.g. rationing water). Consideration may have to be given to use of temporary facilities, such as mobile classrooms, or contracting for short-term use of certain facilities, such as street maintenance equipment or a nearby community's jail facilities.

An example of using population projections to determine capacity "shortfalls" is shown in Appendix A, Table 1.

b. Repair or Replacement of Existing Facilities. Whether a community's population is growing, declining or stable its existing facilities will deteriorate with both age and use and will need repair and replacement. A vital step in determining facilities needs is a forthright appraisal of the physical condition of current facilities. Usually it is best to have personnel within each department make these assessments. For example, road supervisors, the sheriff or chief of police, park director, or fire chief can provide ready assessments of capital needs within their departments. Where a municipality or county employs or retains an engineer or public works director, he can often evaluate many of the community's public works.

To evaluate existing or approved facilities, a local jurisdiction should make a list of all existing buildings and other capital facilities. Information for each facility should include:

- age,
- physical condition,
- capacity, available excess capacity,
- how adequately it does its job,
- what and when repairs or replacement will be needed, and
- last major improvement.

As part of the analysis of existing facilities prepare a list of those projects which (1) recently have been approved, (2) are being built or have had plans completed or (3) have had bond elections approved. The list should include the time when the project will be completed, its design capacity, its costs, how much debt will be incurred and the revenue sources to pay for it.

c. Citizens' Desires. A good faith effort must be made to determine what facilities the local public desires. Many different approaches to finding what projects the citizens view as necessary or important are available. Surveys and questionnaires, personal interviews, contact with civic groups, newspaper publicity, public meetings and workshops can help local officials better know what the taxpayers and other citizens want for their community. These projects must be added to the list for evaluation and priority ranking.

2. COMPILE LIST.

The population projections will indicate whether a community faces growth, stability or decline in the near future. The assessment of existing capital facilities and those approved or underway indicates the extent to which the community faces major repairs or replacement of existing facilities. These two indicators can tell local officials what the future holds regarding the need to expend moneys for capital facilities.

Using design capacities of existing and approved facilities in comparison with population projections, and the estimates of future needs for major repair and replacement, a list of needed new, expanded, repaired, or replaced facilities can be prepared. This approach to developing a needs list avoids the problem of a "wish list" occurring from arbitrary and haphazard listing of a community's "wants."

For each proposed capital project provide information on capacity (relate to population projections), best probable location, alternatives (e.g. delay, expand existing facilities).

In small communities, or those facing decline, the list may be short. Only facilities needing repair or replacement likely would be listed. In larger communities, or those experiencing growth, the list probably would be longer and more complex. New facilties, expansions of existing ones, and portions of existing facilities needing repair or replacement would all be on this list.

SUGGESTION: Don't worry if this preliminary list seems overwhelming and unattainable. It will be narrowed down to fit the financial capability of the local jurisdiction during the priority setting phase.

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3. QUANTIFY CAPACITIES.

The capacity of each facility to serve a given population level must be expressed in quantified design features, such as number of classrooms, square feet of floor space, million gallons per day of treatment, million gallons of storage capacity, miles of roadway or diameter of a trunk line.

For many facilities state or federal agencies enforce certain minimum standards. These standards, of course, must be considered in calculating the minimum size of the facility. Also, local officials may decide that a higher standard is needed. For other capital facilities the only standards are set locally, and here again, local officials must make decisions on the level or standard of service to be provided. DECISIONS REGARDING THE DESIRED LEVELS OF SERVICES ARE VERY IMPORTANT, BUT RARELY ARE MADE WITH CAREFUL CONSIDERATION.

4. ESTIMATE COSTS.

After the needs for new facilities have been quantified cost estimates can be made. Except for projects of high priority or immediate need, be satisfied with rough estimates. Don't worry about detailed costs now. Costs will change in the future, so estimates are sufficient.

SUGGESTION: Use current year dollars. Don't try to factor in inflation at this time. Inflation is too uncertain to consider at this point. However, the fact that current year dollars are used during the forecast period and that inflation has not been included should be prominently explained. When future inflation is ignored the costs of later projects will be understated in capital facilities program.

It is important to identify all the costs associated with the facility. Include the costs of:

- acquiring land and preparing the site,
- construction, installation and purchase costs of the facility and its components,
- debt service(the costs of financing the bonds or other debt),
- of future repair or replacement,
- properly trained personnel to operate the facility,
- associated equipment,
- maintenance and operation,
- planning, engineering and design of the facility, and
- holding bond elections and conducting bond sales.

Building contractors, professional engineers and architects are obvious sources of help for cost estimates. Bankers, bond underwriters and local finance officers can assist with financial and bonding expenses. Because detailed costs are not needed, only estimates, other sources can be used. A similar facility recently constructed in another community can be used as a measure of approximate cost. Personnel within the local department may know the approximate cost of the facility. Personnel in state agencies, such as the Department of Health and Environmental Sciences, or Department of Highways may be able to help.

CHAPTER 6. FINANCIAL ANALYSIS

Local officials should conduct a financial analysis of their jurisdiction to obtain a picture of the projected capacity to finance future capital facilities. The evaluation is, in effect, a cash flow analysis, as well as a projection of bonding capacity. This assessment helps officials predict how much total debt and annual debt service the jurisdiction can incur to finance capital projects.

The financial analysis includes an assessment of past trends in expenditures and revenues, current and future levels of bonded indebtedness, available bonding capacity and future cash flow (revenues and expenditures) without any new capital projects.

Projecting the current bonded indebtedness will indicate the future available bonding capacity for financing capital facilities.

The projected cash flow analysis of costs and revenues without new facilities will show the community's capacity to fund new capital expenditures. Separating the operational budget from the costs for new capital facilities will give the public a clear picture of the relationship between the proposed projects and the overall budget.

Local officials should examine the past and current expenditures and revenues, bonded indebtedness, bonding capacity and taxable valuation in order to thoroughly understand the future capacity of the unit of local government to pay for additional capital facilities.

1. Cash Flow

Cash flow is the difference between recurring revenues and recurring expenditures. Local officials should only rely on annual recurring revenues as a means of supporting added debt payments. Current state or federal grants or other "single purpose" or "one time only" sources of revenues cannot be counted on as future support for new facilities. Thus, property taxes, user fees, earmarked federal or state funds (e.g. federal revenue sharing, state block grant moneys, vehicle license fees) may be used to pay to added costs of new facilities.

It is important to understand that "cash flow analysis" is not related to operating reserves. The term is used here to mean projecting and analyzing future costs, and understanding how the revenues will be derived to meet those costs.

a. Revenues

Revenues from property taxes, licenses and user fees can be projected into the forecast period by assuming the same pattern as past revenues, unless a change in fees or licenses is planned, or a change in mill levy or taxable valuation is expected.

Past earmarked transfers from the state or federal government should be carefully examined to determine if past or current levels can be expected in the future.

b. Expenditures

The first step in analyzing expenditures is to define major categories that are consistent over time. Emphasis should be placed on recurring expenditures. Using major fund accounts from local budgets may provide appropriate categories for expenses.

SUGGESTION: Congress, the Montana Legislature and federal and state agencies will change laws, regulations and program provisions which affect local government revenues, expenditures, debt and bonding capacities. A financial analysis should be prepared using current conditions. As changes in requirements and provisions affect the projected finance picture, the financial analysis should be updated.

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2. Population, Households, Businesses

The population of a jurisdiction is important not only because it indicates a need for facilities, but also because it is a measure of certain revenues, particularly service fees. Often the number of households and business and industry firms are a more accurate measure of "service units" (e.g. water or sewer hook-ups) which pay user fees--monthly service charges, hook-up or tap fees, or investment fees.

The number of households and businesses can be estimated by beginning with the 1980 census. The census often can be updated by obtaining household data from the building permits, number of electric or natural gas hook-ups, telephone hook-ups, or water or sewer hook-ups. By looking a the trends for the past four or five years the future trend may be determined. If any future deviation from the past trends are known, such as new or expanding businesses, businesses closing, or major developments such as mining or government projects, these must be considered in future projections.

SUGGESTION: Be conservative in estimating population or households as revenue sources; estimate on the low side to avoid overestimating future revenues to minimize financial risk. Stable or declining communities particularly may find difficulty in facing the realities of current trends.

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3. Taxable Valuation; Property taxes

A major source of local government revenues comprises property taxes, which are based on a jurisdiction's taxable valuation. Trends of past levels of taxable valuation will give a picture of likely taxable valuations in the immediate future. In projecting future taxable valuation, again look at known or likely private investments and new or expanding firms. Examine the basic industries in the jurisdiction--agriculture, wood pro-

ducts, energy and mineral development and manufacturing. Consider likely increases or declines in each of these industries as indicators of economic trends that would affect the tax base. Finally, consider what changes the Legislature made in tax rates on individual classifications of property.

The trend in mill levies should be reviewed. Of particular importance is whether current mill levies are near or at the legal limits under Montana law.

4. Bonded Indebtedness; Available Bonding Capacity

The means by which local governments incur debt is primarily through issuance of general obligation bonds. These bonds are amortized through tax assessments. Under state law the extent of debt which units of local government may incur is limited to a percentage of the jurisdiction's taxable valuation. Thus, taxable valuation is also important in determining a local government's total bonding capacity. Available bonding capacity, a crucial factor in a jurisdiction's ability to finance additional facilities, is the difference between the legal ceiling and the current committed indebtedness.

Montana law sets the ceiling on a local jurisdiction's bonding capacity:

- a county -- 11 1/4 percent of its taxable valuation;
- a municipality -- 28 percent of its taxable valuation (plus 55% of taxable valuation for water or sewer systems);
- a school district -- 45 percent of its taxable valuation;

To project future available bonding capacity over the facilities program period, subtract the current committed bonded indebtedness from the statutory percentage of the projected taxable valuation.

SUGGESTION: Local officials should review their revenue bonding commitment. While revenue bonds do not affect bonded indebtedness, the bonds still must be retired by citizens in the community through user charges. These charges represent a financial burden on the public. The operating budget positions of the facilities funded by revenue bonds should be reviewed for trouble areas: delinquent payments or escalating operating and maintenance costs. The budgets of these revenue generating facilities can be excellent indicators or forthcoming problems in the communities financial picture.

CHAPTER 7. FACILITY FINANCING

FINANCING METHODS

Finding the best means of financing needed facilities is one of the values of a capital facilities program. Different funding methods are appropriate for different facilities or under different circumstances. Often local officials will find that using several financing methods is advantageous.

Typically, Montana local governments incur debt through bonding. The different types of bonds authorized under state law have particular applications and requirements. It is important to realize that the nature of the proposed facility and type of local jurisdiction tend to dictate the appropriate type of bond, and little choice is really available to local officials. See Appendix C, BONDS; BONDING, for more information on bonding.

Revenue Bonds. Revenue bonds are issued for facilities which generate revenues through user fees. Water, sewer and solid waste systems are the typical facilities which provide revenues through service charges that are used to pay the principal and interest of the bonds (see discussion of fees below). Because revenue bonds are paid from user fees rather than from property taxes they do not affect a jurisdiction's bonded indebtedness. Thus, revenue bonds should be used to finance revenue producing utilities(such as water or sewer systems) in order to save the jurisdiction's bonding capacity for those facilities which do not produce revenues.

A bond election is not required under Montana law for revenue bond issues, but bond buyers view revenue bond issues more favorably where an election has been held.

General Obligation Bonds. General Obligation bonds are retired from revenues generated by a property tax levy. They affect the community's indebtedness and contribute to the jurisdiction's statutory debt limit. The "full faith and credit" of the jurisdiction is obligated in the issuance of general obligation bonds. Thus, the interest rates are lower than for revenue bonds because the commitment of tax revenues provides security. A bond election is necessary to approve a bond issue.

General obligation bonds should be used only for facilities which do not generate revenue and which will benefit all the people in the jurisdiction (e.g. fire stations, jail facilities, arterial or collector streets). Where a facility will serve only a particular geographic area (such as a neighborhood) local officials may find that a special district with a special assessment on only those people benefitting is preferable to community-wide general obligation bonds.

Special Improvement District, Rural Improvement District Bonds. Improvement districts may be formed to provide facilities for certain areas within a jurisdiction. Within municipal limits Special Improvement Districts may be created; within unincorporated areas Rural Improvement Districts may be formed. These districts are formed to provide assessments to pay for improvements such as streets, curbs and gutters, water systems, sewer systems. Improvement districts are created as subordinate agencies of either municipalities or counties. The assessments are levied against properties within a district either on a linear front foot basis, or on the proportional area of each property.

SID or RID bonds are issued to finance facilities within a district. The bonds do not affect the indebtedness of a municipality or county, but if a revolving fund is established as allowed by state statute, the revolving fund is financed from jurisdiction-wide tax levies.

See Appendix D, Special Assessments; Special Districts, for more information on using special assessment districts for facility financing.

County Water and/or Sewer District Bonds. A county water and/or sewer district may be formed by petition to construct water or sewer works, canals, and other facilities related to water drainage or water supply for irrigation, wildlife, livestock or recreation. The district is governed by a board of directors and the board may assess user fees to pay the principal and interest on bonds and cover operation,maintenance, repairs and depreciation of the system(s). If the fees are insufficient to pay the principal and interest on bonds, the electors may vote to levy a tax on property within the district to generate revenues for debt retirement.

Capital Improvement Fund. The governing body of municipalities and counties can establish a capital improvement fund for replacing and acquiring facilities,provided it has formally adopted a capital improvement program. Counties may appropriate up to 10 percent (municipalities up to five percent) of the money derived from any or all authorized levy(ies) to the capital improvement fund. The money deposited in the fund must be expended within 10 years of deposit and must be spent on facilities costing more than $5000 and having a life of at least five years.

Grants and Loans. The number and level of programs providing financial assistance for capital facilities has been reduced significantly. Federal programs available for facilities include: Federal Aviation Administration, HUD Community Development Block Grant (administered by the state Department of Commerce), Farmers Home Administration facilities grants and loans, and Environmental Protection Agency water quality grants (administered by the state Department of Health and Environmental Sciences). State programs include the Montana Coal Board Local Assistance Grants, and Water Development Program and Renewable Resources Development Program by the state Department of Natural Resources and Conservation.

Fees. Fees, of several types, may be assessed to cover a variety of costs. The most common is the user fee, or charge for services. Also known as a user rate, user fees should be charged to cover the costs of operation, maintenance, repair, replacement, and debt retirement.

Local officials should set the fees at a level that will pay for all costs of operation, maintenance, repair and replacement, as well as debt retirement. Utility systems should be self-supporting and not be subsidized by general fund moneys, nor be expected to subsidize other local government fund accounts.

HOOK-UP, or TAP FEES should be high enough to cover the actual costs of physically connecting into a utility line. Those costs usually include the costs of excavating, connecting a service valve into a main line, backfilling and replacing any disturbed public road pavement, curbs and gutters and sidewalks.

An INVESTMENT FEE may be charged to help amortize the debt incurred by constructing the facility. As with a hook-up fee, an investment fee is a one-time fee. Usually, investment fees, when assessed are added to and included as part of the hook-up fee.

Lease; Lease-Purchase. Units of local government may enter into lease arrangements with private companies to provide facilities. Leasing a public works project relieves the government of incurring debt or providing initial capital and other financing. An alternative approach is lease-purchasing, where a project is leased from a private firm and after a specified term the government acquires title to the facility. If the purchase of the facility is required by the lease agreement the cost must be included in the government's indebtedness.

Leasing has been used successfully for solid waste collection, and for obtaining heavy equipment.

Current Revenues. Local governments may finance facilities on a cash, or "pay as you go" basis. The revenues can include fees, taxes, cash reserves and service charges. This method allows a community to save interest costs on borrowed money, protects the bonding capacity and saves the costs and effort of bond issues. However, paying for facilities from current revenues can prevent purchasing facilities when they are needed, can place a strain on current year's tax rates or fees, and inflation will reduce the buying power of accrued funds.

Interlocal Agreements. Often two or more units of local government can realize greater flexibility or economies of scale by jointly financing common facilities. Montana law provides for units of local government to enter into interlocal agreements for sharing costs and facilities.

PUBLIC SERVICE COMMISSION

Cities and towns with municipal water or sewer systems are required to have any proposed rate increases approved by the Montana Public Service Commission (PSC), unless the municipality:

1. must institute a particular rate to finance a facility that is mandated by state or federal agencies to comply with federal drinking water or wastewater discharge standards, or

2. increases its rate less than 12 percent in any year.

The PSC is required to review and approve rates proposed by private water companies. Water users' associations are not subject to PSC approval.

The 1983 Legislature clarified that county water and sewer districts are not subject to PSC approval. Special improvement districts and rural improvement districts do not need approval.

CHAPTER 8. POLICIES

Local officials may wish to adopt a number of policies relating to capital facilities. Policies can help officials in setting priorities, scheduling projects and deciding which finance methods should be used. Certain policies also can determine who will bear the costs of a facility, and can reduce the overall costs to taxpayers.

Municipalities and counties are creatures of the state and receive all of their powers under state law. This fact has tended to create a situation where local officials often pay more attention to procedures than to policy consequences of decisions and actions.

Nearly any set of policies relating to the financing of capital facilities is apt to be controversial. But governing officials may find that adopting at least basic policies will be worthwhile.

Sample policy statements are presented in Appendix B.

Among the first local policy decisions should be what items to include as capital facilities. The list of items which can fall into either capital costs or operating costs should be examined to decide which ones will be treated as capital expenditures. See Chapter 3, DEFINITIONS.

Possible policy statements can span a range from fiscal policies concerning indebtedness to management policies relating to proper maintenance and operation. Elected officials should carefully review the list and seriously consider adopting those policies which seem appropriate for their jurisdiction.

Policies relating to capital facilities can be separated into a number of major categories:

1. Basic fiscal policies primarily deal with debt managment, but also may address use of federal and state transfer funds. Local governments may want to set limits on the extent of indebtedness they would incur. While state law sets legal debt limits, prudent jurisdictions would maintain a debt and bonding reserve for dealing with unexpected capital needs or emergencies. Not ony does maintaining a reserve of bonding capacity avoid tying local government's hands to meet emergencies, but it could improve its bond and credit rating with bond underwriters.

Fiscal policies can encourage the use of state transferred funds and federal funds such as Revenue Sharing or payment-in lieu-of-taxes (PILT) to be used for capital projects or equipment-- "one time only" items. Use of state and federal funds to subsidize the operating budget should be discouraged to avoid the budget "squeeze" when the funds are reduced or eliminated.

Setting up a capital improvement fund account as authorized under state law could be sound policy in order to

build a capital reserve fund.

2. Policies on Allocating Costs among taxpayers, users and others will determine who will pay for public facilities. There are a variety of methods of capital funding, and each has very real implications on who will bear the costs.

Popular finance concepts are "He who benefits pays," and "New growth should pay its way." As a rule of thumb, if a facility serves the community as a whole all citizens, or all taxpayers, should pay the costs. This can be achieved through revenue bonds or general obligation bonds, user fees or general property taxes. If a facility benefits people in a specific area, the people in that area should bear the costs. Special districts are formed to provide a means of assessing people within a specific area for the expenses of public services.

Special districts also are a means of assuring that new growth pays its way for public services. Generally, policies encourage the setting of fees and assessments for specific services high enough to pay for all the costs.

Caution should be exercised for areas of elderly or low income families, or where neighborhoods are beginning to deteriorate. Local officials may wish to deviate from a policy which requires special districts to pay all of the actual costs. See Appendix D, SPECIAL ASSESSMENTS; SPECIAL DISTRICTS and Appendix E, RATE STRUCTURES; SERVICE CHARGES.

3. Policies on financing capital projects might address whether grants will be used. Grants, while reducing the local share of capital costs, can mean local commitments--time may be needed for grant administration, or increased maintenance and operation costs. Grants are probably appropriate for high priority or necessary projects because the local government otherwise would have to pay the entire cost. However, communities should examine carefully the implications of a grant program for lower priority or non-essential facilities to see whether the benefits of the grant offset the obligations represented by the local matching share, future operating expenses and other commitments.

Policies on bonding should limit use of general obligation bonds to those facilities which do not generate revenues--parks, streets, administration buildings or fire stations. Revenue bonds should be used for revenue producing facilities--water, sewer, solid waste or parking facilities. Use of revenue bonds saves bonding capacity for non-revenue facilities.

Special assessment bonds are issued by SID, RID and county water and sewer districts for facilities which benefit a specific area.

A sound bonding policy assures that the maturity of any bond is no longer than the expected service life of the facility.

Conservative growth and revenue projections should be used in planning bond retirement. If growth does not occur as soon or to the extent projected, revenues to make bond payments may not exist.

4. Extension policies place the burden of paying for extended roads or utilities on those receiving the benefits of the services. Governing bodies may want to finance major utility lines and roads to have some control on land use patterns and their effects on the budget. The policy would require developers to pay for improvements within their developments.

Where extensions of utilities must pass by undeveloped lands, the local offcials may want to establish a means of reimbursing the developer for the costs as those properties are developed. A time limit such as 7-10 years should be placed on the reimbursement.

Where a local government requires a developer or special district to install larger facilities than are needed by that development to serve an area beyond, the governing body should pay for the oversized portion. This practice should be pursued only with extreme caution, for it tends to encourage development prematurely. Also, before requiring a developer to oversize his facilities, local officials should have conducted thorough planning to be certain the area is suitable and appropriate for development.

5. Planning, construction and management policies can be of obvious benefit and readily acceptable. But many that are suggested here and in Appendix B may be controversial or otherwise resisted by local officials. Each policy statement is designed to get the most from the public's dollar. Local officials are encouraged to give serious consideration to these suggestions, and perhaps to add others of their own.

Facilities should be designed to meet acceptable engineering and architectural standards and codes. The Montana Uniform Building Code and American Water Works Association Standards are examples of standards which governing officials might approve, and expect facilities to meet. Facilities should be properly constructed and installed and the governing body should provide for inspection to assure that contractors properly construct public facilities.

The personnel hired to operate and maintain public facilities must be properly trained, even certified where appropriate. Misuse, maintenance neglect and improper operation frequently are causes of accelerated deterioration and resulting repair and replacement. Local officials should give proper maintenance and operation top priority to assure maximum physical life.

Communities facing growth may wish to have facilities designed, where possible, to be expanded incrementally as growth occurs. Examples are treatment systems where a lagoon cell or some other feature can be added to expand the capacity, or school buildings that are designed to have classrooms readily added. Where incremental expansion is possible local governments can avoid overbuilding facilities and minimize the financial risk of overestimating growth and revenues. Phased expansion can reduce the large initial capital costs.

Public facilities often can be designed to reduce operation and maintenance costs. Buildings can be well insulated, treatment plants can incorporate systems which have low operating costs, and roads can be constructed with a good base and subbase. Often a particular design which is no more costly can save future maintenance and operation expenses, but typically extra money spent in original construction of a facility can reduce deterioration and thus repair costs.

Local officials should be certain that future maintenance and operation and replacement funding will be available before they approve financing for a capital facility. The fact that a new or expanded facility almost always means increased annual operation and maintenance costs seldom is considered in planning capital facilities.

Governing officials should require that any proposal for extension of roads or utilities be accompanied by a plan showing the proposed service area and estimating the number of users, volume (demand) and timing of need, and the proposed or expected locations of various types of land uses. A plan allows the governing body to review the proposed extension within a "big perspective" -- looking at the overall service area, its size, topography, location and adjacent land uses.

Public facilities can markedly affect future growth patterns and the location of business and industry and other private development. Likewise, the location, design and type of development will affect the public costs of providing services. Typically, growth patterns begin to take shape within an area and the public must come in afterward to provide services within a land development pattern which may or may not be well planned and efficient to serve.

The public can lead, rather than merely follow, development by deciding where it is most efficient and economical to provide services. Thus, local decisions on capital facilities can not only assure an adequate service, but can be an effective means of influencing land use patterns and reducing costs of public services.

Needless to say, local policies on the location of public facilities should be developed within the context of thorough community planning, where desirable areas for development are carefully identified.

If a capital facility has been well planned and designed to efficiently serve an area, the community may take the added step of protecting the adequacy of the design capacity. This can be achieved by adopting land use regulations to assure densities within the service area do not exceed the capacity of the system. Haphazard or high density growth can strain capacities of water and sewer systems particularly, but also can affect roads and recreation facilities.

CHAPTER 9. SETTING PRIORITIES

Virtually every community will find more desirable capital projects than it can reasonably finance. These communities face the need to set priorities to determine which projects will be funded, and when. Inevitably, questions will arise about determining project priorities and project scheduling.

A first step in setting priorities is to determine what criteria will be used. These criteria should be established before rating individual projects.

A number of communities have used criteria which are related to public health and safety. While these are important considerations, facilities such as parks or libraries may never be built.

Local officials may wish to consider criteria based on the community's goals and policies, a project's urgency and immediacy and the availability and flexibility of funding.

Some of the factors that could influence the setting of priorities include:

- Projects not started, but to which the community is committed are high priority;

- Projects that eliminate a hazard to public health or safety are high priority;

- Projects which are necessary to meet state or federal regulations or other legal requirements are high priority;

- Projects which conform to the community's comprehensive plan or adopted policies are given preference;

- Projects which allow the conservation of existing property or resources might be given preference over projects which would require new facilities.

As evidenced by the above suggestions, setting priorities is not purely objective or scientific. Considerable value judgment is involved. The aim should be to use a system that provides as much consistency in the rating of projects as possible. For small communities with only a few projects to consider a simple priority rating system likely will suffice. Larger jurisdictions with many projects may want to establish a point-value rating system to help assure consistency in judgement decisions.

Whatever criteria are used to set priorities, common sense should be a key ingredient.

The following is an example of a priority rating system that might serve a community:

PRIORITY 1:

- Projects already underway, or to which the local government is already committed (funding and all approvals are in hand);
- Projects needed now, and the funding and timing is inflexible -- the project cannot be postponed;
- Projects which would correct a public health or saftey hazard;
- Projects needed to meet state or federal regulations or other legal requirements (e.g., sewage treatment regulations or federal jail facilitiy requirements); and
- Projects needed to assure orderly residential, commercial or industrial development (e.g., a larger sewer trunk to serve a growing commercial area);

PRIORITY 2:

- Projects needed now, but funding and timing is flexible;
- Projects which correct deficient or deteriorating existing facilities;

PRIORITY 3:

- Projects which are highly desirable, funding is flexible;
- Projects which would assist orderly development, not absolutely needed at this time;

PRIORITY 4:

- Projects which are not needed now, but may be in the future; and
- Projects which can be postponed without harming existing programs;

PRIORITY 5:

- Projects which are desirable, but of questionable need;
- Projects which may require more study before commitments should be made

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SUGGESTION: Answers to capital facilities questions do not involve only "yes" and "no". Sometimes, the decisions can be expressed as "not so much" or "not yet." "Not as much" is often an appropriate response to projects which include unnecessary frills. For example, a citizens' group might want to build an Olympic size swimming pool when a smaller one would adequately serve the community.

One of the best questions that can be asked for marginal projects is "What will happen if the project isn't built?" Often the answer to this question can establish a priority better than simply asking what benefits will occur if the project is funded.

After local officials examine the list of proposed projects they may find that certain projects should be postponed. They might decide to defer a project until later after these additional factors are considered:

- project financing has yet to be arranged;
- more research or planning is needed;
- there are legal delays in land acquistion;
- the project must be upgraded to meet new standards;
- legal obstacles or threatened litigation exist;
- conditions have changed and the need for the project has lessened; and
- costs have become too high, or the project has become too ambitious for the size of the community.

When projects are scheduled according to the year construction or acquistion is needed, the proposed capital facilities program may be beyond the ability of the community to finance the first year's program. Local officials may wish to consider rescheduling larger, costlier projects, and, if appropriate, may advance smaller projects of lower priority to allow spending of available capital funds and promote a balanced, even flow of capital expenditures.

Civic Involvement. The people of the community should be given a bona fide opportunity to participate in the development of the capital facilities program from the beginning, and should be involved in the setting of priorities. They should be given the chance to review and comment on the community's needs and priorities, and should be allowed to propose projects themselves. Citizens should be allowed, and encouraged, to propose projects, financing opportunities and means of providing facilities without local government funding.

The value of public participation in the process lies not only in allowing the recipients (and ultimate financiers)of the services to express their desires, but in obtaining their support in bond elections, and for rate and fee increases.

SUGGESTION: Don't wait until the last minute to involve the public or to sell the program. A rejection of a bond issue, or a strident protest to fee increases easily could result.

CHAPTER 10. PROJECT FINANCING AND SCHEDULING

PROJECT FINANCING

For each proposed project the most appropriate financing method(s) must be determined. Where a project is eligible for financial assistance from a grant or loan, the program should be identified, the likely level of funding, when the grant or loan would be available and the time period required for application.

Where all or part of the capital costs must be met through local funding, a decision must be made whether any portion of the costs will be paid from current reserves. For that portion of local funding requiring bonding, the appropriate type of bonds, their maturity and likely interest rate should be identified.

For general obligation, revenue or SID/RID bonds, the overall time involved must be determined. Must a district be formed? Is an election on the bond issue to be held? How long will bond marketing and sale take? The means of repaying the bonds must be decided. User fees, investment fees, property taxes, special assessment or combinations must be determined, as well as the level of the selected finance methods.

DEVELOPING THE CAPITAL FACILITIES SCHEDULE

The proposed projects must be assigned, or scheduled, within the five or six year program. The expected years for new or expanded facilities or repair or replacement of existing facilities will serve as framework for the scheduling. The priority setting previously completed now becomes invaluable. The highest priority projects are scheduled as early as financing will permit.

Priorities may have to be adjusted. For example, a high priority project may have to be scheduled after a lower priority project because financing is not available, or financing for a low priority item may be lost unless it is begun immediately. In another situation a high priority facility would be better delayed to coordinate with another project (for example, paving 2nd Avenue would be delayed until the 2nd Avenue sewer line is installed).

In addition to scheduling a facility within the program, the capital costs should be shown. If costs will be incurred in more than one year (e.g. engineering and land acquisition costs in first year, construction costs in second), those costs should be shown for each appropriate year.

The finance methods planned for each project should be indicated and the availability and timing of the method. Showing this funding information on a draft schedule serves as an additional check on the feasibility of the timing and priorities of the facilities.

Lead Times

Local officials would find value in taking the additional step of determining lead times necessary to bring a facility "on line." To reach completion each project will require a series of legal and practical steps, each needed certain periods of time. Depending on the particular facility, time is necessary for planning and design, land acquisition, bond elections and sales, public notice and hearing, bid letting and contracting. Once local officials have determined when a facility will be needed, they should "work backward" from that date to identify the time when the necessary prior procedures must begin.

CHAPTER 11. ADOPTING A CAPITAL BUDGET; REVIEW AND UPDATE

ADOPTING A CAPITAL BUDGET

After the governing body has adopted the capital facilities program, it probably will wish to adopt the first year's program as part of the annual budget. This step of adopting the capital budget will appropriate funding for the first year projects, and will commit the jurisdiction to incurring the costs and providing the revenues to meet those costs.

REVIEW AND UPDATE

Local officials should review the capital facilities program once a year after adoption. A number of conditions under which the program was developed may change. First, the population may be changing at a different rate or manner than originally thought. Bond issues may fail; expected grants may not be awarded; new technology or other factors may change priorities or needs; each biennium may find Legislative changes in tax rates, taxable valuation, bonding requirements, other revenue sources.

A growing community, or one with a complex capital facilities program likely will find a need to update their program, both by extending the program each year or two to maintain the five or six year schedule, and by reviewing its priorities and needs.

APPENDICES

APPENDIX A

EXAMPLE OF CAPITAL FACILITIES SCHEDULING PROCESS

Table 1 shows, for a hypothetical small municipality in Montana, population projections and the design capacities of a number of facilities.

The community is expecting significant rapid population growth during the next two or three years because of a mine within the county. A peak population of 2500 is anticipated in 1985. After the mine construction is completed the population will level off to between 1700 and 1800 people by 1987. We assume that the population will change little after 1987. (Even though capital facilties are scheduled for only five or six years, population projections are needed for at least 10 years to better understand the long range picture of expected population levels and their effect on capacities of public facilities).

Under the column headed "CAPACITIES" are listed the capacities of the community's public facilities. The capacities are expressed in terms of serving a certain level of population.

The negative numbers show the year in which a capacity shortfall occurs and the extent of the inadequacy. The water distribution system, both the water and sewer treatment plants and the rest home are inadquate now. The degree of capacity shortfall worsens as the population peaks in 1985. The fire station will become inadequate in 1984 and the hospital in 1985. Because the population is expected to level off at approximately 1750 people, the town council should plan to expand the inadequate facilities to serve 1700 to 1800 people rather than 2500, and live with the shortfall during the several years of peak population.

Table 2 lists all of the identified capital facility needs for the community. The needs are listed by the three categories discussed in CHAPTER 5. In the first category, (NEEDED CAPACITY), the needed facilities identified in Table 1 are listed. In the second category, (REPAIR/REPLACEMENT), the needs for replacement and repair are shown. Those needs were identified by the public works director and the City-County Airport Board. The third category, (CITIZENS' NEEDS) shows the needs that citizens identified at a series of meetings the public works director and mayor held with civic groups, senior citizens, and the Chamber of Commerce. The Town Council also held several public meetings as part of their regular council meetings.

People in town generally are aware that poor drainage allows runoff water to collect on the South Side-- flooding streets and basements and accelerating the deterioration of street surfacing. Senior citizens have always needed a social and recreation center and the popularity of softball and community softball leagues has created a recent desire for additional softball/baseball fields.

Table 2 also shows capital costs and possible funding sources for each of the proposed facilities. The two treatment plants are community-wide services and local funding should be

TABLE 1

AVAILABLE CAPACITIES OF FACILITIES TO SERVE PROJECTED POPULATION

		1983	1984	1985	1986	1987
POPULATION		1,575	1,700	2,500	2,100	1,750
FACILITY	CAPACITIES (to serve pop.)					
Water						
- supply	3,000	+	+	+	+	+
- distribution	1,300	-275	-400	-1200	-800	-450
- storage	2,000	+	+	+	+	+
- treatment	1,400	-175	-300	-1100	-700	-350
Sewer						
- collection	1,300	-275	-400	-1200	-800	-450
- treatment	1,500	- 75	-200	-1000	-600	-250
Fire Station	1,600	+	-100	-900	-500	-150
Rest Home	1,400	-175	-300	-1100	-700	-350
Hospital	1,700	+	0	-800	-400	- 50

TABLE 2

LIST OF PROPOSED CAPITAL FACILITIES

PROJECT	YEAR NEEDED	CAPITAL COSTS	SUGGESTED FINANCING
(NEEDED CAPACITY)			
Sewer Treatment plant	1983	$250,000	Revenue Bonds EPA grant
Water Treatment Plant	1983	$125,000	Revenue Bonds
South Side Sewer Collector	1985	$5,000	SID
Rest Home Expansion	1983	$200,000	G.O.Bonds; Rev.Bonds
Fire Station Expansion	1985	$100,000	G.O. Bonds
Hospital	1985	$ 50,000	Revenue Bonds; G.O.Bond
(REPAIR/REPLACEMENT)			
CBD Water Main	1983	$ 50,000	Revenue Bond
First Ave. Resurfacing	1986	$ 36,000	SID
South Side Residential Paving	1987	$100,000	SID;
Reseal Airport Runway	1984	$ 30,600	Airport Bonds; FAA
(CITIZENS' NEEDS)			
South Side Storm Sewer	1983	$234,000	SID Bond; G.O. Bond
Senior Center	1983	$ 75,000	G.O. Bond;
Baseball/softball Fields	1983	$ 50,000	G.O. Bond

through municipal revenue bond issues. The replacement of the old water main in the Central Business District (CBD) could be funded through an SID, or a municipal revenue bond. Many people in the community feel that the downtown businessmen should form an SID because they will benefit the most. Others believe that the downtown area serves everyone in town and that community-wide financing is proper. All three South Side projects serve that specific area and an SID seems appropriate. While the storm runoff problem affects the South Side the water comes from several other parts of town, thus the general community contributes to the problem. A general obligation bond might be appropriate. Private funding within the community will be sought to help finance the senior citizens' center. Otherwise general obligation bonds will be necessary, both for the senior center and the softball fields.

The proposed facilities have been ranked by priority in Table 3. The treatment plants and the rest home were placed at the top of the list because of their existing inadequate capacities. The badly deteriorating CBD water main is also a top priority. The South Side sewer and paving projects were moved ahead a year or so in order that all three projects could be completed at the same time. The South Side streets can be paved after the sewer line is installed and the drainage facilities have been constructed. The other two projects identified by the citizens were ranked next, and the last three projects will not be needed until 1985 or 1986.

The final schedule and financing of the projects is shown in Table 4. The total capital costs and the costs by year are shown.

The Town Council decided to use a general obligation bond to fund the CBD water main and the South Side storm drainage project, believing that both facilities were of community-wide benefit. A G.O. bond is scheduled to finance the senior center. The center will be completed in two phases. The council still hopes to receive private contributions from within the community.

TABLE 3

PRIORITY RANKING

1. Sewer Treatment Plant
2. Water Treatment Plant
3. Rest Home
4. CBD Water Main
5. South Side Sewer
6. South Side Paving
7. South Side Storm Sewer
8. Senior Center
9. Baseball/softball Fields
10. First Avenue Resurfacing
11. Hospital
12. Fire Station
13. Reseal Airport Runway

TABLE 4
SUMMARY CAPITAL FACILITIES PROGRAM

PROJECT	COST($000)	1983	1984	1985	1986	1987	FUNDING SOURCE
Sewer Treatment	250	250					EPA; Revenue Bond
Water Treatment	125	125					FmHA; Rev. Bond
Rest Home	200						
-1st Phase			120				
-Addition					80		G.O. Bond;
CBD Water Main	50		50				Rev. Bond
So. Side Sewer	5			5			SID
So. Side Paving	100			100			SID
So. Side Storm	234			234			G.O. Bond
Senior Center	75				75		G.O. Bond
Hospital	50				50		G.O.bond;
First Av.Resurface	36					36	SID
Reseal Runway	30.6					30.6	FFA; Bond

APPENDIX B

SAMPLE POLICIES REGARDING CAPITAL FACILITIES

A. BASIC FISCAL AND DEBT MANAGEMENT

1. Total incurred debt will not exceed 75% of that allowed by statute.

2. A minimum reserve of bonding capacity will be maintained at a level of 30 percent of the statutory limit.

3. State transfer funds may be used for capital expenditures where authorized.

4. Federal general revenue sharing funds and Payment-In-Lieu-Taxes will be used toward purchase of equipment and capital facilities, rather than to augment annual operating accounts.

5. A capital improvements fund account will be established and maintained to capital expenditures.

6. Capital facilities will be planned and scheduled to assure that a sound cash flow can be maintained.

B. ALLOCATION OF COSTS

1. a. Where a capital facility serves the general public as a whole, all users or taxpayers will bear the costs.

   b. Where a facility serves a specific area or segment of the community, that area or segment will bear the costs. (Exceptions may be made where a high percentage of elderly, retired or low income persons are affected).

   c. Where a facility will serve an area of new development, the residents or firms within that area will bear the costs.

2. A special district must be formed to recover the costs of facilities serving only a specific geographic area.

3. Rate structures will be designed to be fair and equitable to all users.

4. Revenue generating facilities will be self-supporting. Users of the facilities will bear the costs. Fees and charges will be set high enough to retire bonds and recover the costs of proper operation, maintenance, repair and replacement. However, utility rates will not be set higher than needed to fund the systems.

C. PROJECT FINANCING

1. a. Available grants will be used for urgent and high priority projects to reduce the jurisdiction's share of the cost.

b. For lower priority or non-essential facilities the required matching local share and future maintenance and operating costs will be closely examined to fully understand the local financial commitment which a grant program may impose.

2. a. Revenue bonds will used to fund revenue generating facilities.

b. General obligation bonds will be used for non-revenue generating facilities.

c. Special assessment bonds will be used to fund facilities which serve a specific area.

3. The term of any bond will not exceed the expected service life of the facility.

4. Where a facility is planned to meet rapid population growth, bond terms will be no longer than the expected duration of the high population levels.

5. Conservative projections of population and number of users will used in determining revenues from fees, charges and taxes in order to minimize the financial risk if growth is less than expected.

6. Replacement funds will be maintained and allowed to accumulate to a level of 10 percent of the cost of the facility, unless statute, grant regulations or acceptable experience indicates a different level.

D. EXTENSION POLICIES

1. Extension of facilities to serve new areas will be financed by those benefitting.

2. If extensions must pass by undeveloped properties a reimbursement agreement should be provided to allow an appropriate share of the developer's costs to be recovered as the intervening properties are developed. The reimbursement agreement will be valid for up to 7 years.

3. Extensions will meet engineering and construction standards and specifications approved by the governing body.

4. The governing body will finance main and trunk lines and arterial and major collector roads. Developers will finance improvements within a subdivision or development.

If a developer is required to construct facilities larger than needed for his development, the governing body will provide a means of reimbursement for the oversized portion. Reimbursement methods may include cash, a term refunding contract or credit against other fees.

E. PLANNING, CONSTRUCTION AND MANAGEMENT

1. Where possible, facilities will be designed for ready incremental expansion. Extensions will be phased in accordance with incremental demands of growth.

2. New connection fees and user rates will be implemented before new growth occurs.

3. Facilities will be maintained and operated by properly trained personnel. Personnel will be certified where appropriate.

4. Facilities will be designed and constructed to standards and specifications approved by the governing body.

5. All construction and installation will be properly inspected.

6. Facilities will be properly maintained and operated according to approved procedures to assure minimum deterioration and need for repair.

7. New or expanded utility systems must have a plan:
   a. Identifying the service area;
   b. Expected number of users;
   c. Expected timing of growth or development;
   d. Proposed locations of various land use types; and
   e. Expected level of demand for service.

9. The level of service desired from a proposed facilitiy will be determined and articulated. The costs of the facility will relate to the level of service.

9. Where possible, facilities will be designed and constructed to minimize maintenance and operation costs.

10. Before a capital facility is approved, the governing body will assure that funding for all associated future costs will be available.

11. Public facilities will be approved only in locations which will minimize the public costs of providing services to future development resulting from the public facilities.

APPENDIX C

BONDS; BONDING

Issuing bonds as a means to finance capital facilities is complex, and local officials must consult with a qualified bond counsel and other finance or investment officials to assure that issuing procedures are followed and that the best possible terms are obtained. The following information should help local officials understand those aspects of bonding which affect the financing of capital facilities.

Types of Bonds

The three types of bonds used by local government to fund facilities are general obligation, revenue and special assessment bonds. The descriptions of the bonds is presented in CHAPTER 7, FACILITY FINANCING. The recommended uses for each bond are discussed in CHAPTER 8, POLICIES, and in APPENDIX B, SAMPLE POLICIES.

Serial bonds are commonly used to finance capital facilities. For these bonds part of the bond is retired each year. Total interest costs decrease as these bonds are retired. Retirement schedules may be prepared on the basis of level total payments for principal and interest, or of level payments of principal with declining payments for interest. The latter method of retiring bonded indebtedness is recommended because the total cost of borrowing is less. Also, the declining interest costs will make the sale of additional bonds, if desired, more feasible.

Local governments incur bonded indebtedness through issuance of general obligation bonds. State law places the following ceilings on bonded indebtedness based on the taxable value of the jurisdiction:

a. Counties: 11 1/4 percent;
b. Municipalities: 28 percent, plus an additional 55 percent for water and sewer facilities;
c. School districts: 45 percent;

The statutory authorization for municipalities to incur an additional bonded indebtedness of 55 percent for water and sewer facilities is ironic because those utilities can be financed through revenue bonds. The authority may be useful for municipal officials, however, because general obligation bonds usually can be issued at a lower interest cost. Officials should weigh the advantages of lower interest against the debt commitment in deciding whether to use general obligation bonds for water or sewer improvements. Probably in many small towns even 55 percent of the taxable valuation is not sufficient bonding authority to finance water and sewer facilities. Those communities would have to use revenue bonds or grant funds to complete a financing "package."

Terms of Bonds

Montana law specifies the following maximum terms for which bonds may be issued:

a. General obligation: (counties, municipalities, school districts) 20 years;
b. Revenue: 40 years;
c. County water and/or sewer district: 40 years;
d. Special improvement district: 20 years; and
e. Rural improvement district: 30 years, or 40 years if federal loans are used.

At times, the terms of bond issues should be set for less than the statutory maximum. A bond with a shorter repayment term often carries lower interest costs. Also, a bond issue should never have a longer term than the expected life of the facility it is financing.

Officials financing capital facilities in jurisdicitions facing rapid growth or short term growth should issue bonds for terms no longer than the population levels are projected to remain. The population of a rapid growth community may decline before the typical 20 year bond issue is retired. The remaining residents will find it difficult to make the bond payments during the remainder of bond's term because of the lost revenue from taxes or fees.

Methods of Bond Retirement

General obligation bonds are retired from revenues collected by a property tax levied specifically for the purpose of repaying the bond. State law requires the levy to be sufficient to pay the principal and interest on the bond, and that the revenues be placed in a separate account for the issue.

Revenue bonds, by law, may only be issued for facilities which are self supporting. Thus officials must set the fees and rates at a level that will enable timely repayment of the principal and interest of the bonds, and cover the expenses of operation and maintenance.

SID bonds are repaid from revenues collected from assessments on properties within the district. The assessment may be based on (1) the area of the property or (2) on the front footage of the proerty. RID bonds are retired through assessments based on (1) the area of each property or (2) where the district is more than five miles from a municipality, the taxable valuation of each property.

For both SID's and RID's revolving funds may be established to assure prompt payment of bonds as payments become due. The revolving fund is established by a transfer from the local government general fund. The revolving fund may maintain a reserve of up to five percent of the principal in outstanding SID/RID bonds.

Bonds issued by county water and/or sewer districts are repaid from funds collected through user rates. If the user fees are insufficient to meet bond payments the board of directors of the district must notify the county commissioners. The commissioners are required to levy a tax on the properties within the district to collect monies to make the bond payments. The tax assessment may be based on (1) the area of each property or (2) the taxable valuation of each property.

Bond Rating

Bond rating firms evaluate the quality of a local government's credit and bond issues. Two national bond rating firms, Moody's Investors Service, Inc. and Standard and Poor's Corporation provide most bond ratings. The ratings are used by bond buyers or investors as an indication of the reliability of the investment. Generally, higher bond ratings result in lower interest rates.

Small communities may not have had bond ratings, either because of little debt history or its issues are too small to rate. Bonds issued to a federal agency or the State of Montana are not rated.

Local governments can obtain more favorable bond ratings by conducting prudent debt management, long range planning, sound fiscal administration and careful accounting and auditing.

Bond Marketing

Marketing of bonds can present special problems for small communities. They usually have not been assigned a bond rating, and this limits the number of potential buyers.

All general obligation and revenue bonds must carry a legal opinion from a qualified bond counsel as to the validity of the bonds. Any community planning to issue bonds must work closely with legal and investment specialists during the entire process. Retaining a bond consultant or "fiscal agent" for assistance may be advisable. These consultants, usually investment-banking firms, can assist in retaining bond counsel, preparing requests for bids and evaluating the bids received.

Bonds should be sold by competitive bids to obtain the lowest total interest cost. On rare occasions certain bond issues may take place through negotiated sales. In Montana revenue bonds may not be sold through negotiation; under most circumstances any bond should be sold by competitive bid.

Bonds, because of their size, are usually purchased by investment firms, although Montana banks buy small and moderate sized issues. Bond underwriters buy a large percentage of Montana bond issues. Underwriters are usually investment firms that act as an intermediary between the local government and the ultimate bond purchaser. The underwriter buys the issue and resells to investors.

Time Periods for Issuing Bonds

The time involved in issuing bonds varies with the size and complexity of the particular issue and whether bond elections are required or not. Typically, six months will elapse from the time local officials decide a facility is needed until the funding is received. Holding an election will require at least an additional six months depending on when the election is scheduled.

APPENDIX D

SPECIAL ASSESSMENTS; SPECIAL DISTRICTS

Where a public facility primarily will serve a specific area within a local jurisdiction (e.g. street, curbs, water or sewer lines) special assessments often are levied against those specific properties which will benefit. The principle of special assessments is that those who benefit directly from a public service should bear the cost.

Special assessments differ from property taxes in several ways. Special assessments:

1. are levied for a specific service;
2. bear some relationship to the benefit, or level of service received. (Property taxes are levied uniformly without regard to the level of service that any specific property receives).
3. need not be uniform within the district; and
4. are levied against many properties which are exempt from property taxation (e.g., schools, churches). [In Montana, state and federal property is exempt from assessment within SID's and RID's].

Special assessments differ from service charges; they:
1. are levied against property, not property owners; and
2. are less directly related to the level of service provided.

In Montana financing through special assessment requires formation of a special assessment district. Types of special assessment districts authorized by state law include: special improvement districts (within municipalities), rural improvement (in unincorporated areas of counties), lighting, parking, sprinkling, metropolitan sanitary and storm, garbage and ash collection, and local improvement. Capital facilities are funded by issuing special assessment bonds, which are retired through assessments on property paid by property owners within the district.

Special assessment districts are distinct from special taxing districts (the confusion of similar terms is unfortunate), such as fire districts and county water and/or sewer districts. Special assessment districts are agencies of city or county governments and budgets, fees, and assessments are set by the governing officials. Special taxing districts are jurisdictions separate from municipal or county government, are administered by a board of trustees (which sets budgets, fees and tax levies),and levy taxes, rather than fees, against property.

Local governing officials should consider a number of important issues relating to financing of capital facilities through special assessments.

First, The costs of special assessment financing normally are high. The bonds can be difficult to market, the administration, legal and accounting and auditing costs usually are high.

Second, any finance policies which discourage modernizing public facilities (usually through heavy cost burdens) may accelerate the decline of property values and condition of neighborhoods. Conversely, actions which encourage maintenance of adequate facilities could help to maintain or enhance property values and neighborhoods. While this concept probably is true generally, it is particularly applicable in the use of special assessments.

Third, often properties or citizens other than those in the district benefit from the improvements to some degree. Adjacent properties may benefit significantly through increased market values. A wide segment of the general public uses neighborhood streets and other improvements at least occasionally.

Therefore, a question arises -- should the general public pay a share of the expenses for improvements serving a specific area? If so, how should those costs be allocated between the general public and the district?

The fact that public improvements directly benefit property owners within the district and raise the market values of the properties gives strong support for the policy "he who benefits should pay." But a number of reasons have been advanced that special districts provide some general public benefit:

1. The improvements represent capital investment in publicly owned facilities;
2. Improvements in the "public plant," at any location, benefits the community as a whole;
3. The special improvements likely would raise taxable valuations (through increased market values) and thus increase property tax revenues.

A political, but real, consideration is the fact that neighborhood resistance to creating a special improvement district can be reduced if the governing body contributes financially.

No rules of thumb exist for determining how much the public benefits from special improvements. The public benefits minimally from a local street which ends in a cul-de-sac or dead-end, compared to a local through street.

Elderly and Low Income Families; Deteriorating Neighborhoods

Areas or neighborhoods, either with large percentages of elderly, retired orlow income property owners, or which show evidence of physical deterioration present particular concerns regarding special assessments. A "fair share" assessment simply may create hardships for low income property owners. A subsidy from general tax dollars may be in the best public interest to assure the "public plant" is maintained or improved to prevent physical deterioration.

If governing officials decide that certain special districts warrant public contributions, they should set some policies or guidelines to assure some consistency. The policies might define when a district would qualify for assistance, and how the governing body would contribute. Not all special improvements are eligible for financial asssistance from local government. For example, counties legally may not contribute to districts for water or sewer facilities.

APPENDIX E

RATE STRUCTURES; SERVICE CHARGES

Local officials may want to consider several aspects of setting user rates to finance revenue producing facilities.

First, the rate structure must be designed to recover a facility's cost as fairly and equitably as possible for all users. That objective can be met under several different forms of rate structures. Different rate applications include flat rates, uniform rates, step rates, seasonal rates and demand rates.

The flat rate is a constant charge independent of the amount of use. It is usually used for unmetered systems (water, sewer, garbage collection) where the quantity each costumer uses cannot be readily measured.

The uniform rate is the simplest structure for metered systems (typically water). The unit price is constant, regardless of the quantity.

With step rates, the unit price changes as the quantity of water used increases. Historically unit prices have declined as volumes increased. However, it is becoming more common to find increasing step rates where water supply is critical and large users are to be discouraged.

Seasonal rate structures can be used in communities that experience unsually high demands that excessively stress the system. Communities with a large influx of tourists or seasonal residents during summer months are examples. Unit prices can be set higher during the high demand season to encourage water conservation.

Demand rates provide a higher unit price for water quantities used in excess of the average level of use for the system. The concept is that the system had to be built with larger capacity to accomodate the larger users and they should pay the extra cost.

A basic or minimum service charge can be used in conjunction with a uniform or any sliding rate structure.

Wastewater rates can be flat rates, or a uniform or sliding rate in which the quantity is related to the volume of water used by the customer (a relationship between quantity of water used and the volume of wastewater is assumed).

Solid waste charges are usually flat rates,with differing rates for residential, commercial and industrial users. Many Montana communities set commercial and industrial rates not only on increased volume, but also on the fact that the characteristics of commercial and industrial solid waste prevents it from compacting as well as residential waste.

User rates, regardless of the rate structure, should reflect all of the costs associated with the facility.

Separating the costs into several major categories can help simplify the process of rate setting (or at least understanding the components of facility costs):

1. Capital costs involve all the costs associated with putting the facility into use:
   a. Construction and installation;
   b. land acquistion and site development;
   c. engineering, architecture and design;
   d. bond sales; and
   e. interest on bonds.

The capital costs are represented approximately by the principal and interest of the bond issue.

2. Operation and maintenance costs are those costs incurred to operate and maintain a facility:
   a. Salaries, wages and benefits of personnel;
   b. Equipment, supplies, fuel, utilities;
   c. Maintenance and repair; and
   d. Replacement, or depreciation.

Replacement, or depreciation, are appropriate expenses to include under operation and maintenance. The Public Service Commission allows munipalities to set rates to cover depreciation, and the statutes which authorize special districts allow fees to meet replacement costs.

3. Customer service costs include those costs necessary to serve the users:
   a. Billing, collecting, accounting;
   b. Meter reading;
   c. Clerical.

4. Special service costs apply primarily to water systems which provide fire flows.

Capital costs

Where counties and municipalities elect to issue revenue bonds to pay capital costs, the user rate should include bond retirement. Likewise, county water and sewer districts retire bonds through user fees.

Special assessment districts meet debt service costs through a property assessment and need not include bond retirement in user fees.

The amount of the bond issue, its repayment period, interest rates and marketing costs determine the annual commitment of the local government. Which type of rate structure the governing officials use depends on their policies for allocating costs.

Operation and maintenance

Expenses of operating and maintaining a facility should be separated from the other costs.

The debt service charges can remain fixed, and necessary adjustments to operation and maintenance fees will meet the changes in operating costs that occur over time. Thus the user fee can be "fine tuned" periodically, rather than undergoing major revision.

Customer service costs

Customer service costs are relatively minor but they are part of the overall costs. They should be set on a flat rate because serving a small user costs the same as serving a large one.

Special service costs

Communities considering a new or expanded water system face the decision of whether to provide fire protection. For large systems serving 50,000 perople or more the added expense for fire protection is minimal -- primarily the costs of hydrants. In smaller systems, however, the extra capacity needed to provide fire flows represents a large percentage of the total system costs. In small towns the fire protection can be up to 80 percent of the total cost.

In most Montana communities the decision to provide fire protection capacity as part of a water system is an important one. In many cases lower fire insurance rates will partially offset the extra cost of providing fire flows.

Equitably charging users for fire protection can be complex. All properties within the community benefit from fire protection. But the quantity of water use bears no relationship to the level of fire protection provided. An elderly couple living in an apartment might use approximately the same amount of water as a large warehouse. Covering the costs of fire protection through regular user fees would be unfair.

Finding an equitable method of paying the expense of fire flows depends on the assumptions accepted. On the assumption that properties benefit from fire protection in proportion their value, property taxes would be a fair means of paying. That part of a water system designed for fire protection could be paid for through a general obligation bond.

To preserve bonding capacity a fee based on relative proerty value could be set and made a component of the total water rate. Perhaps a more practical approach is to set fees for different categories of users: single family, multiple family, mobile home park, commercial, industrial and public buildings.

FIGURE 6: **SAMPLE CIP PROJECT REQUEST FORM**

PROJECT TITLE	AGENCY REQUESTING	PROJECT STATUS	% COMPLETED
		Feasibility Studies	_____
		Architectural Sketches	_____
PROJECT DESCRIPTION/JUSTIFICATION		Arch Plans/Specifications	_____
		Land Acquisition	_____
		Construction Contracts Let	_____
		Construction Completed	_____
RELATIONSHIP TO COMPREHENSIVE PLAN		Annual Operating Maintenance Cost	$_____
		Estimated Annual Operating Revenue	$_____

COST ESTIMATE	TOTAL	EXPENDED JUNE 30	BUDGET YEAR	SECOND YEAR	THIRD YEAR	FOURTH YEAR	FIFTH YEAR	BEYOND FIFTH
Plans (Contract)								
Land								
Construction								
Equipment								
All Other								
TOTAL COSTS								
SOURCE OF FUNDS								
TOTAL FUNDS								

SOURCE: Gary Meyer, A Practical Guide to Capital Improvement Programming (Des Moines: Iowa Office of Planning and Programming, 1978), p. 12.